

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
O. W. HUBBELL & SONS, INC.	:	DETERMINATION
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
Tax Law for the Period June 1, 1981 through	:	
February 29, 1984.	:	

Petitioner, O. W. Hubbell & Sons, Inc., 100 Main Street, New York Mills, New York 13417, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1981 through February 29, 1984 (File No. 801913).

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 207 Genesee Street, Utica, New York, on October 20, 1988 at 9:15 P.M., with all briefs to be submitted by November 21, 1988. Petitioner appeared by Samuel D. Hester, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Mark Volk, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly determined that certain utilities purchased by petitioner were not consumed in the production of tangible personal property for sale and were therefore not exempt from tax pursuant to Tax Law § 1115(c).

FINDINGS OF FACT

On December 20, 1984, following an audit, the Division of Taxation issued to petitioner, O. W. Hubbell & Sons, Inc., a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period June 1, 1981 through February 29, 1984 which assessed \$21,925.71 in tax due, plus interest.

Petitioner is a manufacturer and contractor involved in the manufacture, sale and installation of guard rails. With respect to the manufacturing aspect of its business, petitioner acquires steel from its supplier and galvanizes this material pursuant to certain specifications. Galvanizing is a process by which a zinc coating is bonded to iron or carbon steel, thereby forming an impermeable barrier against corrosion. Once petitioner has galvanized the steel, it is a finished product and is placed in inventory. A portion of petitioner's product is sold outright. Theremainder of the guard rails are installed by petitioner as contractor pursuant to installation contracts. The installation of the guard rails results in a capital improvement to real property.

The galvanizing process performed by petitioner is part of the guard rail manufacturing process.

The deficiency at issue results from a Division determination that 78.19% of utilities consumed in the operation of equipment used in petitioner's galvanizing process were properly subject to sales tax. On audit, the Division reviewed and totaled petitioner's utility bills associated with the gas and electric meters measuring the consumption of gas and electricity in petitioner's galvanizing plant. The Division assumed that all of the gas and electricity consumed in the galvanizing plant was consumed directly in the operation of the galvanizing equipment and was therefore consumed directly in the production of guard rails. Next the Division examined petitioner's 1983 sales records. The Division determined that \$2,628,672.00 of petitioner's total sales of \$12,053,251.00 (or 21.81%) were "direct sales"; that is, outright sales not involving the installation of the guard rails. The Division determined that these direct sales were properly exempt from sales tax and further determined that the gas and electricity consumed in the galvanizing process with respect to this 21.81% of petitioner's 1983 sales, the direct sales, was properly exempt from tax. The Division further determined that the remaining 78.19% of petitioner's 1983 sales did not constitute sales of guard rails, but were sales pursuant to installation contracts which resulted in capital improvements. Consequently, the Division determined that the utilities consumed in the galvanizing process with respect to these contract sales were properly subject to tax.

The Division then applied the 1983 direct sales/contract sales revenue percentages to petitioner's galvanizing plant's utility bills throughout the entire period of audit. The Division thus assumed that the direct sales/contract sales ratio remained constant throughout the audit period. The Division further assumed that the percentage of utilities consumed in the galvanizing of guard rails for direct sales and installation contracts was identical to the direct sales/contract sales revenue. Thus, since the Division determined that contract sales amounted to 78.19% of total sales in 1983, the Division concluded that 78.19% of the galvanizing plant's utility bills throughout the audit period were properly subject to tax. The application of this

taxable percentage to the galvanizing plant's utility bills resulted in the assessment herein.

Petitioner contracted exclusively with state and local governments to install guard rails. In 1983, petitioner performed work under installation contracts with New York State which generated revenue of \$6,808,273.00. Contract work for Pennsylvania brought in \$637,261.00.

In its computation of petitioner's 1983 contract sales, the Division included \$1,978,967.00 in outright sales of guard rails to corporations affiliated with petitioner. Direct sales of \$1,437,795.00 were made to four affiliated corporations which installed the guard rails purchased from petitioner pursuant to installation contracts. The remaining \$541,172.00 of these sales were to an affiliated corporation which resold the guard rails to contractors.

At hearing petitioner introduced the results of a survey of its galvanizing equipment's gas and electric consumption. This survey was conducted by an electrical contractor. In contrast to the Division's presumption that all of the utilities consumed in the galvanizing plant were used directly in production, petitioner's survey indicated that 27% of the electricity and 93% of the gas consumed in petitioner's galvanizing plant was consumed directly in the galvanizing process. Based on this survey, petitioner conceded its liability for \$6,009.32 in sales tax on purchases of utilities during the period at issue.

SUMMARY OF PETITIONER'S POSITION

Petitioner did not attack the methodology employed by the Division to arrive at the deficiency herein, but did take issue with the results of that methodology. First, petitioner contended that utilities used in the galvanizing of guard rails installed pursuant to contract constituted a use in the production of tangible personal property "for sale". Second, petitioner

contended that its purchases of utilities determined taxable by the Division, and which ultimately resulted in the installation of guard rails under contract with New York State, should be exempt from tax pursuant to Tax Law § 1115(a)(15). Petitioner further contended that its purchases of utilities to produce guard rails which were ultimately installed pursuant to contracts with the State of Pennsylvania should be exempt from tax as out-of-state sales.

CONCLUSIONS OF LAW

A. Section 1115(c) of the Tax Law provides for an exemption from the taxes imposed under Tax Law §§ 1105(a) and (b) and 1110 for, inter alia, gas and electricity used or consumed directly and exclusively in the production of tangible personal property for sale by manufacturing or processing.

B. Petitioner's process of galvanizing guard rails for use on its road improvement projects, along with the utilities directly consumed in connection therewith, did not constitute the production of tangible personal property for sale within the meaning of Tax Law § 1115(c) (see Matter of Midland Asphalt v. Chu 136 AD2d 851, 852). The production of tangible personal property for use by the producer in capital improvement projects is not a production of property for sale within the meaning of section 1115(a)(15) or (c) (see, Matter of Southern Tier Iron Works v. Tully, 66 AD2d 921, 922, lv denied 46 NY2d 713). Consequently, the Division properly determined that the utilities consumed in the galvanizing of guard rails installed by petitioner pursuant to its installation contracts were subject to tax.

C. The Division erred, however, to the extent that it determined to be taxable utilities consumed in the galvanizing of guard rails sold by petitioner to affiliated corporations. Guard rails produced for sale as such constituted the production of tangible personal property for sale

within the meaning of Tax Law § 1115(c), and the purchase of utilities consumed in the production of such guard rails is exempt from sales tax pursuant to Tax Law § 1115(c). Utilities consumed in the production of guard rails for sale to affiliated corporations were therefore properly exempt from tax. The Division is therefore directed to recompute the exempt/nonexempt utilities ratio determined on audit by including as exempt from tax petitioner's 1983 sales to affiliated corporations (\$1,978,967.00). The Division is then directed to apply the adjusted taxable ratio of 61.77% ($[\$2,628,672.00 + 1,978,967.00]$ divided by $\$12,053,251.00 = 38.23\%$ nontaxable and 61.77% taxable) to petitioner's utility purchases throughout the audit period (see Finding of Fact "4").

D. Petitioner's contention that the purchases of utilities in question were properly exempt from sales tax pursuant to Tax Law § 1115(a)(15) is without merit. Tax Law § 1115(a)(15) offers an exemption from tax for receipts from certain sales of tangible personal property. "Tangible personal property", for purposes of Tax Law § 1115(a)(15), specifically excludes gas and electricity (see Tax Law § 1110[b][6]). The exemption offered by Tax Law § 1115(a)(15) is therefore unavailable to petitioner. Petitioner's contention that utilities consumed in the production of guard rails installed pursuant to contract with the State of Pennsylvania should be exempt is also without merit for the reasons set forth in Conclusion of Law "A".

E. The petition of O. W. Hubbell & Sons, Inc. is granted to the extent indicated in Conclusion of Law "C"; the Division of Taxation is directed to adjust the notice of determination issued December 20, 1984 in accordance therewith; and, except as so granted, the petition is in all other respects denied.

DATED: Troy, New York

May 25, 1989

/s/ Timothy J. Alston

ADMINISTRATIVE LAW JUDGE